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The Pension Digest

ALSO IN THIS ISSUE –

Collin W. Fritz and Associates, Inc.,
"The Pension Specialists "

On May 28, 2020, the IRS Postpones Deadline for Form 5498 Until August 31, 2020

The IRS finally issued additional and express guidance on the filing deadline for the Form 5498, Form 5498-SA and Form 5498-ESA.

See Notice 2020-35. This notice amplifies the definition of Affected Taxpayers as provided in Notice 2020-23 to define the filer of Form 5498, Form 5498-SA and Form 5498-ESA as being an Affected Taxpayer. These amplified definitions, rather than the definitions in Notice 2020-23, apply for purposes of the relief described in this section III.

The relief is, the due date for filing and furnishing Form 5498, Form 5498-SA and Form 5498-ESA is postponed to August 31, 2020. Note, an institution now has some filing and furnishing flexibility. It could decide to file with the IRS by June 1, 2020, but could furnish the accountholders with their forms at a later time or vice versa.

CARES Acts And Related IRS Guidance Brings 4 HSA Law Changes

1. Contribution Deadline. The tax deadline was changed to be July 15, 2020, from April 15, 2020. The tax deadline is also the deadline for a person to establish an HSA for tax year 2019 and to make a contribution for tax year 2019.
2. The CARES Act changed the law so that in one over-the-counter situation (menstrual care products) the purchase is to be treated as a medical expense for HSA purposes. Code section 223 was amended. See section 3702 of the CARES Act. CWF doesn't believe the purchase of a menstrual care product qualifies as a medical expense which could be claimed as a deduction under Code section 213. Code section 213 was not amended. At this point we have not seen the authority that the law has been changed so that all or other over the counter drugs or medicines now qualify as the payment of a medical expense for HSA purposes. Other websites may say the law for OTC has been changed, but we have not found the legal substantiation yet.
3. Telemedicine Expenses Are Exempt from the HDHP Deducible Limit. A qualifying HSA HDHP may now pay telemedicine expenses even though the person has not met the HDHP's deductible limit. This new law applies in the case of plan years beginning on or before December 31, 2021.
4. COVID-19 Expenses - Can Be Exempted From the Out-of-Pocket Calculation. Apparently the HDHP may be written so the individual is not required to pay any out-of pocket coasts associated with the testing and treatment for COVID-19. The HDHP can pay these expenses regardless that the individual has not met his or her out-of-pocket limit.

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Treasury Inspector General For Tax Administration Audits the IRS With Respect to the 10% Additional Tax

On May 22, 2020, the TIG released an audit report with the title, “Additional Actions Could Improve Compliance With Early Retirement Distribution Requirements.”

The gist of the report, the IRS should take certain steps so more taxpayers pay the 10% additional tax which they owe regarding IRA and pension plan distributions received before age 59½. The auditor had four recommendations for the IRS. The IRS agreed with three of these recommendations, but disagreed with the fourth. The audit report available to the general public is heavily redacted. The IRS thought the auditor should have reviewed more data and that this lack data adversely affected the value of the audit report.

The IRS’ main tax compliance tool is its Automated Underreporter (AUR) Program. Its computers systematically match taxpayer income and deductions against the information reported by third parties on information returns to identify discrepancies and inconsistencies. The IRS does not review or seek taxpayer explanation on every identified discrepancy because of its limited resources (lack of personnel).

The auditor reviewed AUR Program data provided as of May 20, 2019, for tax year 2016. 102,988 cases were identified where taxpayers reported an early distribution, but did not pay the 10% additional tax. The cases were handled as follows:

1. The IRS selected 8,429 cases to work on further and decided it would not work on the other 94,559.
2. Of the 94,559 cases not selected, 51,757 had prepared the Form 5329 and 42,802 had not.
3. Of the 8,429 cases selected to be worked by the IRS,
   - A, 2737 did receive a tax assessment;
   - B. 716 were determined to not owe the 10% tax;
   - C. 1101 were closed with no tax owing; and
   - D. 3875 were still under review.

The auditor thought the IRS had sufficient information to impose an additional $15 million in taxes on account of taxpayers failing to pay the 10% additional tax.

We at CWF could not conclude from the audit report whether the auditor understand that there are times when the taxpayer is not required to file Form 5329 and that even if Form 5329 is filed by the taxpayer that the taxpayer at that point does not furnish proof that they qualify for the exception. Proof is only furnished if the IRS sends a follow-up letter. It appears the IRS rarely sends any follow-up letter.

In summary, IRA custodians and trustees work hard to properly prepare the Form 1099-R and Form 5498. The IRS can and will assess substantial fines if these forms are not prepared timely and correctly. The IRS and the Department should review their present forms and procedures, but they too should be doing a better job.

How is an IRA Disaster Distribution to be Reported on the 2020 Form 1099-R?

We believe the IRS has or will be adopting the position that reason code “2” is to be used to report an IRA disaster distribution. The IRS should improve its discussion on this subject. A person does not owe the 10% tax when their IRA distribution is a disaster distribution.

Presently reason code 2 (exception known) is used in box 7 of Form 1099-R when the IRA distribution is on account of an IRS levy, a distribution related to a Roth conversion or a distribution pursuant to a substantially equal periodic payment.

Note we at CWF have changed our position on this reporting issue. Earlier in the year we informed IRA custodians that you would use reason code 1 and then the individual would complete Form 5329 to claim the exception from the 10% tax.

Our email guidance as set forth below explains why we have changed our position. We are in the process of revising our IRA distribution forms so that the individual will certify whether or not their distribution is a disaster distribution. An IRA custodian is authorized to rely on your customer’s certification.

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Q1. With the passing of the CARES Act, will you be updating any of the forms on the system for individuals under $59^{1}/_{2}$ that are withdrawing IRA funds? On the current IRA Distribution form, there are only options for under $59^{1}/_{2}$ as shown below. If no changes are made, should we select Option 1 or 2 for clients?

I certify the reason for my distribution by checking the appropriate box below which best describes the reason for this withdrawal.

1. ❍ Before Age 59 1/2 and No Known Exception or on account of a distribution to a qualifying military reservist, certain medical expenses, education expenses, payment of health insurance premiums, first time home buyer expenses, certain birth and adoption expenses or one-time transfer/direct rollover to an HSA.

2. ❍ Before Age 59 1/2 but an Exception Applies (check one)
   - ❍ Conversion/Rollover to a Roth IRA
   - ❍ IRS Levy
   - ❍ Substantially Equal Schedule (certification to be furnished)
   - ❍ Disaster Distribution

A-1. An IRA accountholder under age $59^{1}/_{2}$ who takes a disaster distribution does not owe the 10% tax of code section 72(t).

Before your email, my answer to your question would have been - use selection/code “1” and the individual is to claim the exception to the 10% tax by filing form 5329 and inserting exception #12. See attached page 4 of the IRS instructions for Form 5329.

We now believe the IRS wants the IRA trustee to make the determination that a person is taking a disaster distribution.

Previously, we believed the IRS would have the recipient of a disaster distribution claim the exception to the tax by completing Form 5329 as is done for other exceptions where the IRS does not require the IRA trustee to determine if the person has met all the requirements for the exception.

We now believe the IRS approach is - the IRA trustee makes this disaster determination and

it is to use code “2”. Why? The CARES Act provides the IRA trustee is allowed to rely on the person’s certification.

After reviewing the IRS instructions, we will be modifying our IRA distribution forms to show a disaster distribution as the fourth type of IRA distribution which is a reason code “2” distribution. We presently have a disaster distribution under reason code “1”. It will be removed.

IRS instructions for Form 1099-R are not clear how the IRA trustee is to report a disaster distribution. See the attached chart - Guide to Distribution Codes.

In this guide the IRS does not expressly mention a” disaster distribution.” There is no mention of “disaster distribution” under reason code “1”. However, see the last sentence of reason code “2”. Use code “2” for “Any other distribution subject to an exception under code section 72(q), (t), (u) or (v) that is not required to be reported using code 1, 3 or 4.” We believe the IRS intends that a “disaster distribution” is covered by this sentence. Code 1,3 or 4 is NOT used to report a disaster distribution.

One of the reasons why we are making this change is because of the IRS instructions for Form 5329 (page 4) the individual may insert “12” for when a distribution is a qualified disaster distribution or when a distribution has been incorrectly indicated as early distribution by code 1, J, or S.

We will try to contact the IRS to see if they will clarify their instructions, but often it is difficult to get a clarifying explanation. We will keep you informed if we learn more from the IRS.

DOL and IRS Grant Relief to 401(k) Plans and Participants Due to COVID-19 and Related Subjects

401(k) participants wonder about their right to receive a disaster distribution from their employer's 401(k) plan. Employers wonder if their 401(k) plans must be revised to permit such distributions. Employers wonder what happens if some or many of their 401(k) participants become delinquent in repaying their 401(k) loans.

Basic 401(k) and pension law is: the plan document provisions must be followed. Some law changes require the plan document be amended and other law changes do not. That is, an employer has the right and in some cases the requirement to amend their 401(k) plan document. Some amendments are mandatory, but most are discretionary.

The plan document will define when a participant is eligible for a distribution. Most employers write their 401(k) plan to make a terminated participant eligible to take a distribution.to have attained the plan's normal retirement age (e.g. age 65) in order to be eligible for a distribution. The law has been written to restrict distributions to active participants of a 401(k). The law does not require an employer to make a distribution to a participant who has suffered a hardship. It may choose to do so. The law defines what events will qualify a distribution as a hardship.

An employer will need to decide how it will amend its 401(k) document on account of the SECURE Act and the CARES Act. Some amendments will be mandatory.

Mandatory changes

Employers must amend their 401(k) plan document to set forth the following changes.

The SECURE Act changed the definition of a person's required beginning date. For years after 2019 for a 401(k) plan it is April 1 of the year following the year a person attains age 72 or it is the April 1 of the year which is the later of attaining age 72 or the year of separation for a non-5% owner participant.

The CARES Act waived all RMDs for 2020.

The SECURE Act changed the laws applying to an inheriting beneficiary.

Apparently, a participant of a birth or adoption distribution must have the right to repay such a distribution to a plan.

Discretionary Changes

All non-mandatory changes are discretionary changes. The plan document must set forth the new provisions the employer implements.

An employer may, but is not required to, define a hardship distribution as a COVID-19 distribution.

Deadline for Plan Amendments - Relief.

The DOL will treat a plan as being operated in accordance with the terms of the new amendment prior to its actual adoption if the amendment is made on or before the last day of the first plan year beginning on or after January 1, 2022, or such later date as determined by the Secretary of he Treasury and that it meets the conditions of section 2202(c)(2)(B) of the CARES Act.

What relief is granted by the DOL?

In Notice 2020-42 the IRS grants temporary relief from the physical presence requirement for spousal consents under qualified plans due To COVID-19.

The DOL announces that a plan, employer, a participant or a beneficiary will have an additional year in which to comply with certain deadlines.

A plan will not be in violation of ERISA for failure to timely furnish a required item during the time period commencing on March 1, 2020 and ending 60 days after the announced of the COVID-19 national emergency as long as the plan acted in good faith.

What relief is granted by the IRS?

In general, The IRS in Notice 2020-23 and 2020-28 extended the filing deadline to July 15, 2020.

An individual will have an extended time to make loan repayments. The extended deadline is December 31, 3020.

If an individual is eligible for a distribution, he or she must determine if the distribution qualifies as a disaster distribution and report it as a disaster distribution on their tax return.

An employer is not required to write its plan so the plan will accept the repayments of a disaster distribution.

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If the participant has certified that a distribution is a disaster distribution, their Form 1099-R is to be prepared with a reason code 2 in box 7. See the related article in this newsletter.

IRS Guidance – Plan Distribution to Foreign Persons Require Withholding

The discussion below summarizes the withholding rules applying when a U.S. qualified plan makes a distribution to a foreign person. The same basic rules apply if the payer is an IRA custodian.

Does your U.S. retirement plan make distributions to foreign persons? If so, you must generally withhold 30% of the payment for federal income tax (IRC Section 1441(a)).

How do I document the status of a payee? You must generally withhold 30% from a plan distribution paid to a foreign payee unless you can reliably associate the payment with valid documentation that establishes the payee is:

- a U.S. person, or
- foreign person entitled to a rate of withholding lower than 30%.

Documentation can include Form W-9, Form W-8BEN, or other appropriate sources.

If you don't have documentation, you may be able to apply a lower withholding rate but only if you can verify that the recipient is a presumed U.S. person under the tax regulations.

How do I determine a payee's status if I don't have documentation? If you can't reliably document the status of a retirement plan distribution recipient as a U.S. person or a foreign person entitled to lower withholding, you should apply the presumption rules in the tax regulations (Treasury Regulation Section 1.1441-1(b)(3)(iii)(C)).

Who can I presume is a U.S. person? A retirement plan distribution is presumed to be made to a U.S. person only if the withholding agent:

- has a record of a **Social Security number** for the payee, and
- relies on a **payee mailing address** that's
  1. in the United States, or
  2. in a foreign country with which the United States has an income tax treaty in effect giving its residents exemption from U.S. tax on payments of this type.

A payment that does not meet these rules is presumed to be made to a **foreign person**. See Treasury Regulation Section 1.1441-1(b)(3)(iii)(C) for the complete rule.

Examples of withholding errors Plan sponsors and third party administrators are withholding agents and may be liable for taxes and penalties for improper withholding.

No withholding on distribution to a presumed foreign person

The Employee Plans Examinations group has seen situations in which the plan withholding agent didn't withhold federal income tax on plan distributions that constitute U.S. source income to participants residing in foreign countries, specifically when:

- The participant resides in a country with which the United States **doesn't** have an income tax treaty in effect that entitles the payee, if a resident in the treaty country, to a U.S. tax exemption on their qualified plan distributions;
- The plan sponsor didn't secure Form W-8BEN, Form W-9 or other documentation to determine the payee's status as a U.S. person; and
- The plan sponsor reported the distribution on Form 1099-R.

These participants are **presumed to be foreign persons** and their distributions should be **reported on Forms 1042-S** with 30% federal income tax withheld.

Improper withholding at a reduced rate

IRS auditors have also seen situations in which a reduced rate of federal income tax (less than 30%) was improperly withheld on qualified plan distributions that constituted U.S. source income to participants residing in foreign countries, specifically when:

- The participant resides in a country with which the United States **doesn't** have an income tax treaty in effect that entitles the payee, if a resident in the

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Email Guidance – Inherited IRA Beneficiary Believes RMD for Year of Death is to go to the Deceased IRA Owner

Q-1. We are getting a repeated question from a beneficiary regarding the 1009-R we issued to the IRA owner (the father) and the 1099-R we issued to the beneficiary (the son).

We issued a 2019 1099-R to the father for the amount he withdrew from his IRA account prior to death. As the RMD wasn't fully satisfied but the owner prior to death, the beneficiary (son) took the remaining RMD amount before 12/31.

The son is citing IRS publication 590, and says that we issued the 1099-R incorrectly. He is asking us to report the total taken from the IRA on the 1099-R to the father, and to cancel the 1099-R we issued to him. I am not in agreement, but do not have information other than the 590 to back this up.

Are we wrong here? And do you have any information that you can point me to that I can provide to him? He wants to meet about this again soon, so any information you can point me to would be appreciated.

A-1. You are not wrong. I will assist you in explaining to him (the son) why he is wrong.

What section/page of the Publication 590-B does he cite as being the authority that his father's remaining 2019 RMD is treated as being distributed to his father rather than to him even though he was the person to whom it was actually paid?

The general tax rule is, Form 1099-R must be issued to the person who received the distribution. I am aware of no exception to this rule, even for the year a person dies.

Publication 590-B is written for the individual. The instructions for Form 1099-R are written for the IRA trustee. If there would be an inconsistency between these two IRS publications, an IRA trustee must follow the instructions for the Form 1099-R.

Another tax rule is, a beneficiary is required to withdraw the decedent's RMD to the extent it had not been distributed to the decedent.

Please email whatever he is citing?

Q-1A. I am glad that you agree, as we have always issued the 1099-R to the parties receiving the funds in these cases. Here is what he is saying:

Per the attached, which I just pulled off the web information: Overall Gross Distribution from IRA was $12,850.76, not $9,900. All the listed items on my attachment were meant to meet his minimum RMD for the year, which didn't change because he passed - per the tax laws ref: IRS Publication 590-B, page 8:

"If the owner died before the required beginning date, there is no required minimum distribution in the year of the owner's death. For years after the year of the owner's death, see Owner Died "Owner Died Before Required Beginning Date, later, under IRA Beneficiaries.

If the owner died on or after the required beginning date, the IRA beneficiaries are responsible for figuring and distributing the owner's required minimum distribution in the year of death. The owner's required minimum distribution for the year of death generally is based on Table III (Uniform Lifetime) in Appendix B. However, if the sole beneficiary of the IRA is the owner's spouse who is more than 10 years younger than the owner, use the life expectancy from Table II (Joint Life and Last Survivor Expectancy). ***Note.*** *You figure the required minimum distribution for the year in which an IRA owner dies as if the owner lived for the entire year."*

The $12,850.76 is the full amount from the IRA, but $9,900 was paid to the owner prior to death, and the rest was split between the two IRA beneficiaries. It seems he is in agreement that the funds need to come out of the IRA, but not with how we are reporting it on the 1099-R. We issued three, and I think he expected one. If I could have something to point to it would be very helpful.

A-1A. For the following reasons, the three 2019 Form 1099-R's as prepared with respect to the Inherited IRA are correct. There is no authority for Comerica Bank to correct the 1099-R forms as requested by the son beneficiary.

The son beneficiary believes/argues that only one 2019 1099-R should have been prepared for his father, the deceased IRA owner and that the other two 1099-R forms for him and the other beneficiary should not have been prepared.

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Email Guidance,
Continued from page 6

The IRS issues a large amount of guidance on many different subjects, including inherited IRAs. Sometimes this guidance is not as comprehensive or clear as one would like. Sometimes IRS guidance is directed to an individual taxpayer. For example, IRS Publication 590-B (IRA Distributions) is directed towards an IRA accountholder or a beneficiary. At other times IRS guidance is directed at the IRA trustee. IRS instructions for Form 1099-R are written for the IRA trustee.

The following are cardinal IRA tax laws. See the attached research materials:

1. An IRA trustee must prepare a Form 1099-R for any person (or tax entity) which is paid an IRA distribution of $10 or more.

I have sent you 3 pages from the 2020 instructions for Form 1099-R. The 2019 instructions are presently unavailable because of the CARES act changes.

2. The person who withdraws funds or is paid funds from an IRA is required to include such distribution in their income unless there is a reason it is not taxable (i.e non-deductible contribution or basis). I have sent you page 5 of IRS Publication 590-B. See the highlighted portion. "Beneficiaries of a traditional IRA must include in their gross income any taxable distributions they receive."

The son beneficiary is arguing there is an exception because his father (the IRA owner) died after his required beginning date. He had withdrawn most of his RMD prior to his death, but not all of it. The son and the other beneficiary were paid their respective shares of this remaining RMD. The son is arguing that the IRS discussion on page 8 modifies the above discussed tax rules so that it is proper for the IRA custodian to prepare just one Form 1099-R for his father. There is no such authority.

The IRS discussion on page 8 does not change the two fundamental rules.

The IRS states on page 8 states the following, it is the duty of the beneficiary or beneficiaries to calculate the RMD for the year the

IRA accountholder dies when the IRA owner died after his required beginning date. Note the beneficiary has this duty and not the IRA custodian.

The son beneficiary believe the IRS Note (see page 8) creates the necessary authority to prepare the Form 1099-R solely in his father's name. I don't believe it does. The Note is, "you figure/calculate the required minimum distribution for the year in which the

IRA owner dies as if he had lived for the entire year."

This does NOT mean, for purposes of preparing the Form 1099-R the IRA trustee is to treat distributions made to someone other than the IRA owner as being made to the IRA owner. "Figuring or calculating the RMD" and "distributing the RMD to specific persons" are two different events.

The RMD for a given year does not change on account of the person's death. That is, the RMD amount is not adjusted because the person did not live the entire year. Another rule is, to the extent the RMD was not distributed to the IRA owner prior to his death, it must be distributed to the beneficiary or the beneficiaries by December 31.

In summary, your preparation of the 3 Form 1099-Rs was correct.

IRS Guidance,
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treaty country, to a U.S. tax exemption on their qualified plan distributions; and

- The plan sponsor didn't secure Form W-8BEN, Form W-9 or other documentation to determine the payee's status as a U.S. person or foreign person.

In this situation, the participant is presumed to be a foreign person (Treasury Regulation Section 1.1441-1(b)(3)(iii)(C)).

A withholding agent who makes a payment to a person presumed to be a foreign person **may not reduce** the **30% withholding** on it unless the beneficial owner furnishes a Form W-8BEN withholding certificate (Treas. Regs. Sections 1.1441-1(b)(3)(iii)(C) and 1.1441-1(e)(2)(i)). Because the withholding agent didn't secure Form W-8BEN from the participant in this situation, federal income tax should have been withheld at the 30% rate.

Additional resources

- Nonresident alien withholding
- Treasury Regulation Section 1.1441-1(b)(3)(iii)(C)
- International Issues Affecting Retirement Plans
- Tax Information for Plan Sponsors

IRS Issues 2021 Indexed Amounts for HSAs

The maximum HSA contribution for 2021 is $3,600 for single HDHP coverage and $7,200 for family HDHP coverage. The HSA contribution limits for 2021 are $50 higher for single HDHP coverage and $100 higher for family HDHP coverage.

The minimum annual deductible limits for 2021 do not change. The minimum deductible limit for single coverage for 2021 is $1,400 and the minimum deductible limit for family coverage is $2,800.

The maximum annual out-of-pocket expense limit for single coverage for 2021 increases to $7,000 from $6,900 and the out-of-pocket expense for family coverage increases to $14,000 from $13,800.

On May 20, 2020, the Treasury Department and Internal Revenue Service issued new guidance on the maximum contribution levels for Health Savings Accounts (HSAs) and out-of-pocket spending and deductible limits for High Deductible Health plans (HDHPs) that must be used in conjunction with an HSA. The HSA 2021 limits are set forth in IRS Revenue Procedure 2020-32.

High Deductible Health Plans

HSA Maximum Contribution Limits Under Age 55

	2019	2020	2021	Change
Single HDHP	$3,500	$3,550	$3,600	+ $50
Family HDHP	$7,000	$7,100	$7,200	+ $100

HSA Maximum Contribution Limits Age 55 & Older

	2019	2019	2020	Change
Single HDHP	$4,500	$4,500	$4,600	+ $50
Family HDHP	$8,000	$8,100	$8,200	+ $100

HSA Catch-Up Contributions

	2019	2020	2021	Change
Age 55 and Older	$1,000	$1,000	$1,000	$0

High Deductible Health Plans

	Minimum Annual Deductible			Maximum Annual Out-of-Pocket Expenses		
	2019	2020	2021	2019	2020	2021
Single Coverage	$1,350	$1,400	$1,400	$6,750	$6,900	$7,000
Family Coverage	$2,700	$2,800	$2,800	$13,500	$13,800	$14,000